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E.O. 12958: N/A
TAGS: ECON ELAB EIND ETRD KTDD EINV BR
SUBJECT: BRAZILIAN INDUSTRIAL POLICY INCREASES GOB'S HOLD ON
ECONOMY

SENSITIVE BUT UNCLASSIFIED--PLEASE PROTECT ACCORDINGLY

REF: A. Sao Paulo 0207 B. Sao Paulo 0264

¶1. (SBU) SUMMARY: The Brazilian government announced on May 12 a new industrial policy intended to stimulate economic growth with a goal of growing GDP by five percent per year from 2008 to 2010. The Productive Development Policy incorporates financing and tax breaks to achieve four main objectives: increase investment as a share of GDP, stimulate research and development for industrial innovation, expand Brazil's share of global exports, and provide incentives for more small and medium size exporters. However, most interlocutors have said the new plan is unlikely to have any noticeable impact on economic growth. The policy visibly increases the state's participation in the economy, a potentially negative development for Brazil. END SUMMARY.

GOB LAUNCHES NEW INDUSTRIAL POLICY

¶2. (U) On May 12, President Lula unveiled the Productive Development Policy (PDP) aimed at stimulating investment and domestic production of goods to increase Brazilian exports. The GOB is striving to maintain five percent GDP growth from 2008 to 2010 by redoubling its efforts in four target areas: increasing fixed capital investment from 17.6 to 21 percent of GDP by 2011 for a total of USD 385 billion in 2010; stimulating private investment in research and development of industrial innovation from 0.54 percent of GDP to 0.65 percent in 2010; expanding Brazil's share of global exports from 1.18 to 1.25 percent of total world exports by the end of 2010; and increasing small and medium-sized export companies by 10 percent to a total of almost 13,000 companies by 2010.

TAX CUTS AND LOW-COST LOANS TO BOOST EXPORTS

¶3. (U) The GOB plans to stimulate the four target areas via financing and tax incentives. On the financing side, the Brazilian Development Bank (BNDES) is set to distribute USD 131 billion over three years to finance industrial production and services, with additional financing benefits for capital goods investment. (Note: BNDES President Luciano Coutinho said that this total excludes financing made available for infrastructure projects under the

Program for Growth Acceleration (PAC) unveiled in 2007. End Note.) Tax breaks, including credits for capital goods purchases, and reduced financial transactions and industrial taxes would total USD 12.5 billion by 2011 to boost industrial production; however, some of these tax breaks already exist. According to Bear Stearns, the GOB's main objective is to provide incentives to the Brazilian export sector to help contain the appreciation of the Brazilian currency and ultimately strengthen Brazil's external accounts. The GOB also has marketed the PDP as a way to improve Brazil's competitiveness in high-tech industries and promote domestic industries that serve a majority of the population such as construction, IT, and agriculture.

TARGETS BY INDUSTRY

¶4. (U) Following are targets by industry through 2010:

--Civil construction: Increase productivity by 50 percent.
--Capital Goods: Investment of USD 11.5 billion, increase in R&D and increase exports;
--Made-to-Order Capital Goods: Double exports and increase investment in R&D;
--Wood and Furniture: Increase domestic sales by 15 percent; increase exports by 7.5 percent and increase domestic market consumption by 30 percent;
--Hygiene and Toiletries: Increase exports to reach USD 700 million;
--Leather and Footwear: Increase exports of leather products by 10 percent;
--Plastics: Double exports to reach USD 2.2 billion;

--Automobiles: Target production to reach four million units by 2010 and 5.1 million by 2013;
--Aerospace: Double production and exports and maintain third place in world ranking;
--Agribusiness: Increase exports by 25 percent;
--Services: Increase service exports to USD 40 billion
--Naval: Increase domestic content to reach 85 percent;
--Information Technology: Promote software and IT services to increase revenues to USD 3.5 billion;
--Meat: Promote exports to reach USD 14 billion;
--Textiles: Increase revenues to USD 41.6 billion;
--Cellulose, Mining, and Steel: Increase investment and keep Brazil among the five top worldwide producers;
--Biodiesel: Increase production to 3.3 billion liters;
--Ethanol: Increase production to 23.3 billion liters and increase to reach 5 billion liters;
--Oil and Natural Gas: Increase oil production to 2.4 million barrels per day;
--Healthcare: Decrease trade deficit to USD 4.4 billion by 2013;
--Defense: Invest USD 1.4 billion in modernization and R&D and increase purchase of Brazilian-made goods;
--Biotechnology: Stimulate the creation or development of 100 small and medium companies.
--Nanotechnology: Increase investment to USD 70 billion in R&D, innovation, and science and technology.

IT AND CAPITAL GOODS PRIORITY INDUSTRIES

¶5. (U) The Brazilian IT industry is set to reap significant potential benefits from the new PDP. The policy allows IT firms to reduce their social security contributions from 20 to 10 percent and to deduct research and development expenses from a federal tax on net profits (CSLL) and corporate income taxes. The GOB also announced USD 598 million in public investment to expand the software and IT services industries through 2010.

¶6. (U) The PDP also includes a provision that allows domestic industrial manufacturers of capital goods, automobiles, and auto parts to reduce depreciation of investments in domestically produced capital goods from a period of 10 to two years. According to the private think tank Institute of Industrial Development Studies (IEDI), more than half of the USD 3.8 billion in tax breaks on

investments would go to auto manufacturers and auto parts in Brazil. Indeed, the Ministry of Finance calculated that these two sectors would save approximately USD 1.9 billion from now until 2010 in tax breaks thanks to the accelerated depreciation.

MIXED-REACTION

¶7. (SBU) Brazilian industry has reacted cautiously to the GOB's industrial development plan. Former Finance Minister and Economist, Luis Carlos Mendonca, although satisfied with the plan, highlighted the need to support domestic producers in sectors that export to China over sectors competing with China. According to Paulo Skaf, President of the Sao Paulo Federation of Industries (FIESP), the measures appear positive, but FIESP needed more details to make a comprehensive analysis. Jackson Schneider, President of the Brazilian National Auto Industry Manufacturers Association (ANFAVEA), is in favor as the PDP provides strong benefits for the auto industry. However, others including IEDI have criticized the implicit preferential treatment for the auto industry, noting that the auto industry did not require financial support and cited as evidence the sector's phenomenal performance to date. (Comment: Brazilian auto sales are up 31 percent and production is up 10 percent over the same period last year. For more information on Brazil's auto sector see Ref A. End Comment.)

¶8. (SBU) Interlocutors in the Sao Paulo finance community told Econoff that they view the PDP as a political initiative that would be ineffective at stimulating Brazil's productive sector. Emy Shayo of Bear Stearns said that the GOB's immediate goal of combating the Brazilian currency's appreciation by promoting exports is unlikely

to be of much benefit as export gains are currently driven by high commodity prices which have little to do with government incentive policies. Furthermore, Shayo would have preferred universal and deeper tax benefits that would address Brazil's high tax burden, which continues to be the Brazilian industry's biggest concern. In her view, Brazil's industrial policy should have instead targeted emerging industries that are unable to compete in the global marketplace and that have a potential comparative advantage.

COMMENT

¶9. (SBU) The PDP has a clear undertone of greater state intervention in the Brazilian economy and is another example of forces within the Lula Administration's preference for greater state participation in influencing the marketplace (Ref B). The GOB's attempt to pick winners and losers is unlikely to stimulate economic growth and keep the economy growing at five percent per year. Indeed, the plan appears to target Brazil's most robust industries rather than helping improve conditions for industries that are unable to meet market demand such as the chemicals and metallurgy industries. The PDP fails to address the tax reforms needed to sustain economic growth. Despite the fanfare, it is unclear whether the GOB has the resources to implement the new industrial policy. Instead, the government would do better to reduce spending, simplify and reduce taxes, and use excess revenues to accelerate its payment of public debt. END COMMENT.

¶10. (U) This cable has been coordinated with and cleared by Embassy Brasilia.

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